SUMMARY of COOPERATIVE CASES

FARMER COOPERATIVE SERVICE
U. S. DEPARTMENT OF AGRICULTURE
WASHINGTON, D. C.

SUMMARY NO. 65 SEPTEMBER 1955

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The comments on cases reviewed herein represent the personal opinion of the author and not necessarily the official views of the Department of Agriculture.

APPELLATE COURT DECIDES TENNESSEE BURLEY CASE

(Ivan Range v. Tennessee Burley Tobacco Growers Association _____ S.W. 2d_____ (Tenn.))

On August 24, 1955, the Court of Appeals of Tennessee decided a case brought by eleven members of the Tennessee Burley Tobacco Growers Association against the association and its manager. The Appellate Court (1) agreed with the lower court that the complainants had failed to establish waste or mismanagement; (2) held that complainants could not bring a representative action for other growers; but (3) held that the association, under its contract with Commodity Credit Corporation, could not use farmer equities (available from the sale of tobacco after payment of the price support loan and all expenses) for capital unless expressly authorized by Commodity Credit Corporation to do so. It entered judgment for the individual complainants for their pro rata shares of such equities.

In the lower court (see Summary No. 61, p. 1) it was held that the complainants had failed to establish waste or mismanagement and that the association had no right to retain certain net margins realized from the sale of members' tobacco as revolving capital reserves. The lower court held, in effect, that all the patrons should be given the option of having the net proceeds either paid to them in cash or invested in capital of the association. Both sides appealed.

The tobacco involved had been pledged as security for price support loans, the association acting as agent for Commodity Credit Corporation to administer the program. The tobacco, having failed to bring the support price, was acquired and held by the association after payment to the growers of the support price. It was later sold by the association for more than the loans for which it was pledged, thus creating an equity for the growers. The association's agreement with Commodity Credit Corporation required these excess amounts to be "distributed" to the growers "unless other disposition is approved by CCC." The association's marketing contract provided for retaining reasonable reserves, so it contended that it had "distributed" the amounts when it allocated the "reserves" to the growers. The complainants contended that the "distribution" had to be in cash.

As indicated above, the Appellate Court held that the Commodity Credit Corporation contract controlled and meant distribution in

cash unless Commodity Credit Corporation authorized other disposition. It found that such other disposition had not been approved.

On the issues of waste and mismanagement and the right of the complainants to sue in a representative capacity, the court said, in part:

> "In addition to the construction of permanent facilities for the handling and storage of tobacco and the purchase of machinery, bookkeeping equipment and the like, complainants insist that excessive amounts have been expended in employing auditors and attorneys, per diem allowances and expenses of officers and directors, conducting an educational program designed to inform members of operations of the Association relative to growing, processing and marketing tobacco and in various other ways expending funds of the Association. In developing their insistence as to alleged waste, complainants in their proof have gone into great detail and conducted the most minute inquiry into such matters as the expense of dinner meetings and tips to waitresses at such meetings, the expenditure of a few dollars for a small present to the wife of the President of the Association, traveling expenses of the wife of the Manager on two or three occasions and the employment of unnecessary help on warehouse floors at times when no tobacco was being handled by the Association.
>
> "We find that the construction of permanent facilities and the purchase of machinery and equipment was approved by the duly elected Board of Directors of the Association in furtherance of its corporate purpose. Dinner meetings were held to discuss affairs of the Association as customary in such organizations. The undisputed evidence shows that an audit of the books and records revealed no dishonesty in the handling of funds of the Association.
>
> "In the absence of fraud or corruption or ultra vires activities, not here shown, the intrusion of a court of equity into the internal affairs of a corporation is generally not warranted. The stockholders have their remedy within the corporation if it engages in activities or pursues policies deemed inimical to the interests of stockholders."

* * * * * *

"In this case complainants failed to invoke the action of the Board of Directors and we do not find circumstances excusing their failure to do so. The proof shows no more than a diversion of opinion among stockholders and directors with the majority prevailing."

On the question of the right to maintain a class action, the court said, in part:

". . . any right to maintain the present action must be limited to the right of complainants, if any, to recover in their status as creditors equities arising from the sale of tobacco. In the absence of a showing of insolvency, can they maintain a class action for the recovery of such equities? We think not for two reasons:

"(1) The proof tends to show that a great majority of the 70,000 or more producers entitled to equities desire to leave them with the Association. . . . Quite aside from this, however, each producer has his action unaffected by complainants and without relation to their claims. As shown by the answer above quoted, as well as by the proof, the Association admits that the producers own the equities subject only to its right to use them temporarily as a part of its revolving capital. There is no reason to assume that if the courts reach a contrary conclusion a multiplicity of suits would be required due to refusal of the Association to pay on demand."

* * * * * *

"(2) We think a court of equity should decline to entertain the present action as a class suit for the distinctly different reason that complainants are not in the true sense suing in behalf of other producers. Though complainants are shown to be entitled to equities, some are stockholders in warehouses while others are employees of warehouses. It is admitted that warehousemen who are not shown to be members are conducting this suit and have employed and under certain contingencies have agreed to pay complainants' counsel. It is apparent that a conflict of interests between the warehousemen and the Association is, at least conceivable. In the absence of some compelling reason to the contrary, a court of equity, under such circumstances, should confine the recovery to the parties complainant."

On the third point at issue, the court said:

"The question of the right of the Association to use the equities as revolving capital with which to conduct its

charter functions must be resolved in the light of the intent of the Congress in creating Commodity Credit Corporation and providing it with funds to support the price of certain selected commodities, including tobacco."

* * * * * *

"The legislative intent was to aid producers by securing for them at least 90% of parity for their products. In the case of tobacco the practice has been that the crop of each producer is graded by a Government agent according to quality and condition before it is offered for sale. In view of this practice of dealing with producers as individuals, it cannot be assumed that, because a grower is assured of receiving 90% parity, it was intended that he is to be considered as having received the full value of his crop or that his property rights in any sum above parity would be, in any way, impaired. As demonstrated by the sales of tobacco by the defendant Association it was to be expected that in many cases the tobacco would eventually bring more than parity price. And, as we have seen, the Association concedes all of this except that it now claims the right to hold payment of equities in abeyance until they can be replaced by equities arising from the sale of subsequent crops.

"We will not lightly ascribe to the Federal Government an intent to benefit third parties at the expense of the grower who is the prime beneficiary of the Act even though such third parties may be other producers."

* * * * * *

"The contract is articulate as to what the Association is to receive for its service in carrying out the support program. If additional benefits were to accrue to it, it must be assumed that they would have been spelled out in plain terms and not left in doubt.

"Any right of the Association to infringe upon the rights of growers must derive either from the Federal Government which made possible the realization of a profit or from the grower whose crop the Association has sold. In our opinion it has not been able to trace its claim to either source. We think any grower reading the contract in advance of the sale of his crop would have concluded that 'distribution' meant distribution in cash upon the liquidation of the crop for the year rather than allocation according to cooperative usage and

custom upon the books of the Association. As to such grower's crop under its contract with Commodity Credit Corporation, the Association was to act as an agent of the Federal Government and not in its capacity as a cooperative benefiting the industry as a whole."

* * * * * *

". . . we know of no reason why the Association may not yet request and obtain an official ruling from the Commodity Credit Corporation and, if adverse, invoke the action of the Secretary."

SECOND "INITIAL DECISION" ISSUED IN APPALACHIAN APPLE CASE

(C. H. Musselman Co., et al., F.T.C. Doc. No. 6041, August 18, 1955)

In 1952, the Federal Trade Commission issued its complaint charging an incorporated trade association and several apple processors, including Knouse Foods Cooperative, Inc., with entering into "an understanding, agreement and combination" in restraint of trade in raw apples in the Appalachian area. An "Initial Decision" on April 15, 1953, dismissed the complaint on the grounds of insufficiency and lack of substantiality of the evidence. (See Summary No. 56, p. 10.) Appeal from this decision was taken to the Commission, which, on September 15, 1954, set aside the hearing examiner's initial decision and remanded the proceeding for further action.

The matter was reassigned to another examiner and further hearings were held. The new examiner again concluded that the evidence did not substantiate the charges and, on August 17, 1955, issued an order that the complaint be dismissed.

SECOND "INITIAL DECISION" AND ORDER ISSUED IN FLORIDA CITRUS MUTUAL CASE

(Florida Citrus Mutual, F.T.C. Doc. No. 6074, August 9, 1955)

A Federal Trade Commission examiner has ruled in a second "Initial Decision" that Florida Citrus Mutual, the nonprofit citrus marketing association of Lakeland, Florida, and its members have unlawfully restrained competition in their efforts to stabilize the Florida citrus industry. This decision is being appealed to the full Commission.

This case has been in process since December 1952. Originally, a Federal Trade Commission examiner ruled in an initial decision in June 1953 to dismiss the complaint. (See Summary No. 57, page 11.) However, an appeal before the Commission by counsel in charge of the complaint resulted in a reversal and reference back to another hearing examiner in May 1954. (See Summary No. 60, page 14.) Hearings were again held in Washington and Lakeland.

Hearing Examiner Everett F. Haycraft in this latest initial decision held that Mutual had, prior to May 1952 illegally fixed the minimum resale price charged by fresh fruit shippers and processors. The ruling also held that the cooperative had allotted the quantity of fresh fruit bought from its members which could be shipped in interstate commerce. Although the examiner admitted the alleged activities had been abandoned, he said the contracts are still in effect "and a change in policy or administration (by Mutual) could bring them into use" to compel observance of price fixing and allotment programs. To block this possible use, the examiner issued a restraining order.

Perhaps the most far reaching result of the decision was the examiner's rejection of Mutual's defense that it was properly organized as a Capper-Volstead Act cooperative, and the contracts which it had with its producer members on one hand and fresh fruit shippers and processors on the other, were authorized by that Act, and, therefore, immune from the antitrust laws. The examiner held that the association did not market fruit for its members, but worked on a broader scale to operate for the benefit of handlers and processors as well as producers.

MARKETING CONTRACTS - LIQUIDATED DAMAGES; INJUNCTION; TERMINATION

(Marvin v. Pueblo Dairymen's Cooperative, 284 P. 2d 238 (Colo.))

Suit was brought by a milk marketing association to enjoin a dairyman from violating his marketing contract and to obtain the liquidated damages for breach specified in the contract. The dairyman counterclaimed for the amount of damages he sustained by not being able to sell his milk outside the association during the time the restraining order and injunction were in effect against him by court order. The Appellate Court found that the dairyman, after he had breached his contract, had also terminated it in accordance with its terms. It held that under these circumstances injunction was unwarranted. It allowed the dairyman to recover on his counterclaim the amount of damages he had proved less the amount of liquidated damages he owed the association under the contract.

Defendant cooperative was organized under the cooperative marketing Act of Colorado, which provides for the remedies of injunction, specific performance, and liquidated damages for breach of a marketing contract. The established facts showed that plaintiff joined the association on December 1, 1941; that he had 28 cows; that he complied with his marketing contract from December 1, 1941, to December 16, 1952, on which date he stopped delivering milk to defendant.

On May 5, 1953, defendant commenced this action against him asking for all three remedies and a temporary restraining order. The latter was granted, whereupon plaintiff resumed delivering all his milk.

On December 23, 1952, the board of directors of the cooperative met and decided to "accept checks from members at $5.00 per cow" for those who had stopped delivery to the association and also voted to return $5.00 and take the share of stock from members paying the liquidated damages. On January 25, 1953, plaintiff notified the defendant orally that he was "staying out" and this fact was recorded in the minutes of a directors' meeting held on that dayfor the purpose of giving a hearing to producers

who had "jumped their contracts." On November 18, 1953, the temporary restraining order was replaced by a preliminary injunction to continue until determination of the action on the merits. During the month of March 1954, plaintiff gave defendant written notice of termination of his contract, as required therein, and again stopped delivering milk on May 1, 1954.

On August 17, 1954, the court entered an injunction and judgment finding that the contract had been terminated on May 1, 1954, but that the preliminary injunction was in effect until that date. He further held that the cooperative should recover liquidated damages in the amount of $140, but that the dairyman should recover nothing on his counterclaim. The dairyman appealed.

The court, after reciting the facts and setting out pertinent parts of the minutes of the board meetings held on December 23, 1952, and January 25, 1953, said in part:

> "The latter minutes show definitely that defendant Marvin was staying out. By paragraph 9 of the agreement, hereinbefore set out, it was provided that on May 1 of any year after the contract has been in force for one year, either party may cancel the contract by notifying the other party in writing of such intention, and that the notice be given during the month of March immediately prior to the effective date of cancellation. This provision is clearly for the purpose of giving plaintiff at least thirty days notice within which to make other arrangements to procure the milk it would fail to get from the member cancelling out. It is undisputed, and fully disclosed by the minutes of the board of directors, that on January 25, 1953, plaintiff had notice that defendant was no longer going to deliver the milk produced by him to plaintiff. What could be a more effective notice for the termination of the contract as of May 1, 1953, than is disclosed by defendant's testimony and the minutes of the directors' meeting? This was actual knowledge, and it superseded any other requirement of notice. It was a fact known at that time by both parties to the agreement; therefore, with this knowledge, plaintiff did not need a further formal notice of something it already knew. The meeting on that date was for the very purpose of a hearing as to this particular question as to who was continuing under the contract or who was dropping out. Plaintiff, having called a meeting for that purpose, received the information or notification at that time, it is not now in any position to claim that it did not have notice, and that the contract continued to May 1, 1954, when in fact it was terminated by the action of both parties as of May 1, 1953.

"At the time of this meeting plaintiff knew of its statutory right to an injunction provided solely for its benefit; however, it voluntarily took the action disclosed by the minutes of its board of directors' meeting on December 23, 1952 and thereby waived any right it had to an injunction against defendant. This voluntary choice and action by plaintiff was the very essence of the waiver. It is obvious that only the contracts made with its members could be enforced by plaintiff, and defendant was no longer a member after his stock 'was lifted' according to the resolution above quoted, after defendant 'had jumped' the contract and a hearing held thereon.

"The restraining order and injunction entered against defendant herein were, under the facts disclosed and not denied, wholly unwarranted, and since there is no evidence contradictory of defendant's statement that he was damaged in the sum of $1,400 by reason of having to take less for his milk under the compulsory orders of sale, he is entitled to judgment in that amount.

" . . . We believe, and so hold, that under the marketing agreement in the instant case, the marketing association had no further remedy beyond the stipulated amount for liquidated damages, because the producer was not bound as to any specified time and did deliver and perform under the contract for a period of eleven years and exercised his right to quit and complied with the terms of the agreement in connection therewith.

"In accordance with the views herein expressed, the judgment is reversed and the cause remanded with directions to reinstate defendant's counterclaim and enter judgment thereon in the amount indicated."

LIMITATIONS ON COOPERATIVE DIRECTORS - STATUTE CONSTRUED

(Oliver v. Halstead, 196 Va. 992, 86 S.E. 2d 858)

Members of a cooperative milk producers association brought this action against the association and one director, who was employed as business manager, to enjoin the director from acting and receiving a salary for his services as manager and to enjoin the association from paying him for such services. The lower court denied the relief asked and the members appealed. The Appellate Court affirmed.

The court said, in part:

> "The single question presented is whether Halstead, a director of the Association, may during his term of office receive compensation for services as a business manager. The answer to this question rests upon a proper construction of Code, Sec. 13-266(c), which provides:
>
> > "'An association may provide for the payment of a fair remuneration for the time actually spent by its officers and directors in its service. No director, during the term of his office, shall be a party to a contract for profit with the association differing in any way from the business relations accorded regular members or holders of common stock of the association, or to any other kind of contract differing from terms generally current in that district'
>
> "This section of the Code contains no express restriction or limitation prohibiting a director of a Co-Operative Farm Product Marketing Association from acting and receiving compensation as its business manager. The first sentence authorizes the Association to pay a 'fair remuneration for the time actually spent by its officers and directors in its service.' In addition to the requirement that the remuneration be fair, the second sentence provides that no director 'shall be a party to a contract for profit with the association differing in any way from the business relations accorded regular members or holders of common stock of the association, or to any other kind of contract differing from terms generally current in that district.' There is no allegation that

Halstead's contract of employment is unfair; therefore, our inquiry is confined to the determination of whether his salary is paid under a 'contract for profit.'

"The word 'profit' is defined in Black's Law Dictionary (3rd ed.) as 'The advance in the price of goods sold beyond the cost of purchase. The gain made by the sale of produce or manufactures, after deducting the value of the labor, materials, rents, and all expenses, together with the interest of the capital employed.' There is a clear distinction between 'profit' and 'wages' or compensation for labor. 'Compensation for labor can not be regarded as profit within the meaning of the law. The word "profit", as ordinarily used, means the gain made upon any business or investment--a different thing altogether from mere compensation for labor.' Commercial League Association of America v. People ex rel. Needles, Auditor, 90 Ill. 166. 'Reasonable compensation for labor or services rendered is not profit.' Laureldale Cemetery Association v. Matthews, 354 Pa. 239, 47 A. 2d 277, 280.

"When Code, Sec. 13-266(c) receives a reasonable construction it is clear that a contract under which a director of the Association is also employed for a fair remuneration as business manager does not constitute a 'contract for profit'. The primary purpose of this statute is to authorize fair remuneration for the services of directors and officers and to prevent a director from gaining any contractual preferences with the association not available to the general membership.

"Code, Sec. 13-250 provides: 'The provisions of the general corporation laws of this State, and all powers and rights thereunder, shall apply to the associations [Co-Operative Farm Product Marketing Associations] organized hereunder, except where such provisions are in conflict with or inconsistent with the express provisions of this chapter.'

"We have been directed to no provision of the general corporation law which prohibits a director from acting for fair compensation as business manager of his corporation. Furthermore, there are no express provisions in Chapter 15, Title 13 of the Code nor any provisions of the Association's by-laws, which are in conflict with the general corporation law that

a director may also serve his corporation in some other capacity for a fair remuneration. In fact this is common practice and sanctioned by the law if the contract of employment is otherwise fair and honest. Sterling v. Trust Company of Norfolk, 149 Va. 867, 141 S.E. 856; Ransome Concrete Machinery Co. v. Moody, 2 Cir., 282 F. 29; 4 Michie's Jur., Corporations, Sec. 166, p. 700 et seq.; 5 Fletcher on Corporations (1952 Revised Volume) Sec. 2126, p. 528.

"Consequently, we hold that the 'contract for profit' referred to in Code, Sec. 13-266(c) does not include a contract of employment and does not prohibit the payment of a 'fair remuneration for the time actually spent' by Halstead as business manager of his association. Therefore, the judgment is affirmed."

ANNUAL MEETINGS - REGULARITY; PROXY VOTING

(Haaland v. Verendrye Electric Cooperative, 69 N.W. 2d 502 (N.D.))

These proceedings were brought by the "Haaland group" to have the declared election of directors of an electric cooperative set aside. At the annual meeting the "Birdsall group" had been declared elected. The lower court held the election invalid, ordered the Birdsall group from office and determined that the Haaland group had been elected. The Birdsall group appealed.

The Appellate Court reversed the lower court. It held that (1) the electric cooperative was subject exclusively to the North Dakota Electric Cooperative Corporation Act under which it was formed; (2) the cooperative had validly amended its bylaws prior to the meeting to preclude proxy voting; (3) the election committee properly rejected proxy votes which the Haaland group tried to cast; and (4) corporate elections will not be set aside for trivial irregularities which would not have affected the result.

The following excerpts from the opinion, dealing with the alleged "irregularities," may be of interest as indicating objections which the court regarded as "trivial":

"The committee in charge of the election prepared an official ballot. The plaintiffs claim that this ballot was unfair to them because the candidates of the Haaland group were mostly listed farther down on the ballot than the Birdsall group. Candidates listed on the top half were grouped under the

heading 'Names submitted by the Nominating Committee. There were eleven names submitted by the nominating committee, eight being of the Birdsall group, one of the Haaland group, and two that apparently had no factional affiliation. Blank lines were provided for writing in the names of candidates not listed. On the bottom half of the ballot were 'Names submitted by Petition.' There nine candidates were listed, one being from the Birdsall group and the other eight from the Haaland group. After each name and blank line was a square in which the voter could designate his choice. The campaigning between the two groups was spirited. Each distributed lists or guide cards containing the names of the directors supported by the respective factions.

"It is obvious from a study of the results of the election that the position on the ballot had little to do with the number of votes the candidates received. The votes received by the Birdsall group ranged from 518 to 586. The high vote was received by the Birdsall group candidate whose name was listed among those submitted by petition and was the fourth name from the bottom of the page. The votes received by the Haaland group ranged from 262 to 390. The name of the low candidate in this group was among those submitted by the nominating committee and its position was third from the top of the page. The plaintiffs have wholly failed to demonstrate that they suffered any serious disadvantage because of the arrangement of names on the ballot.

"The plaintiffs complain that the president, Mr. Birdsall, departed from the order of business prescribed by the bylaws by permitting speeches to be made that were 'slanted' in favor of the Birdsall group prior to the balloting. Some speeches were made but there is nothing in the evidence to indicate that they were partisan or controversial. The only implication that they were 'slanted' comes from the questions of plaintiffs' counsel. The record does not show that these incidents interfered in any way with a fair election.

"Plaintiffs also contend that the length of time consumed in balloting in some way militated against a fair expression on the part of the voting members. Balloting began about 9:30 a.m. and lasted until about 4:30 p.m. The committee in charge required the prospective voters to register and checked their membership before permitting them to vote. There is no evidence of any specific person who did not have an opportunity to vote, although one witness states that some members

went home without voting. Three tables were set up for registration and prospective voters were registered three at a time. Sometimes there was a lull in the registration. If any implication is to be drawn from the length of time that the polls were open, it would seem to be in favor of a fair election and a free expression of the will of the members in attendance.

"The lowest candidate of the Birdsall faction received 128 more votes than the highest candidate of the Haaland group. It does not appear that any incident or incidents of which the plaintiffs complain militated against them to the extent of causing them to lose the election. Corporate elections will not be set aside for trivial irregularities which it appears have not affected the result. 19 C.J.S., Corporations, Sec. 720a, page 41."

DIVIDENDS OR INTEREST FOR FEDERAL INCOME TAX PURPOSES

(Crawford Drug Stores, Inc. v. United States, 220 F. 2d 292)

This was an action to recover payments of income taxes. The issue was whether certain payments made by the taxpayer on certificates which it had issued were dividends or interest. The lower court held that the payments were dividends on preferred stock and were not deductible. This judgment was affirmed by the Circuit Court of Appeals, 10th Cir.

Judge Bratton said, in part:

> "No all-comprehensive rule has been evolved and accepted for ready use in determining in all cases whether a payment of the kind here in question constitutes payment of a dividend on stock or interest on indebtedness. Precedents abound. But because of the widely varying facts underlying the conclusions reached they do not provide a ready test. No single characteristic is necessarily decisive in all cases. The basic question whether the payees are stockholders or creditors and whether the payments constitute dividends or interest turns upon the consideration of all the relevant facts. John Kelly Co. v. Commissioner, 326 U.S. 521, 66 S. Ct. 299, 90 L. Ed. 278; Bowersock Mills & Power Co. v. Commissioner, 10 Cir., 172 F. 2d 904; Commissioner of Internal Revenue v. O. P. P. Holding Corp., 2 Cir., 76 F. 2d 11; Wetterau Grocer Co. v. Commissioner, 8 Cir., 179 F. 2d 158. But in distinguishing between payment of dividends on stock and payment of interest on indebtedness, the determining elements usually recognized for appropriate consideration are the name given to the certificates, the presence or absence of a maturity date, the source of the payments, the status of the holders in respect to being equal or inferior to that of regular corporate creditors, and the intention of the parties.
>
> "These certificates were styled and repeatedly referred to throughout as preferred stock. The name given to securities is not conclusive in respect to their nature. Certificates called one name may have the predominating characteristics of the other. Jewel Tea Co. v. United States, 2 Cir., 90 F. 2d 451, 112 A.L.R. 182; Commissioner of Internal Revenue v. Schmoll Fils Associated, 2 Cir., 110 F. 2d 611. But the

nomenclature used by the parties is a factor not to be ignored. Commissioner of Internal Revenue v. O. P. P. Holding Corp., supra; First Mortgage Corporation of Philadelphia v. Commissioner, 3 Cir., 135 F. 2d 121; John Wanamaker Philadelphia v. Commissioner, 3 Cir., 139 F. 2d 644. These certificates had a definite maturity date. And the presence of a definite maturity date in such certificates is an important factor indicating that they represent indebtedness as distinguished from preferred stock. Bowersock Mills & Power Co. v. Commissioner, supra. But a provision of that kind is not conclusive. Pacific Southwest Realty Co. v. Commissioner, 9 Cir., 128 F. 2d 815, certiorari denied 317 U.S. 663, 63 S. Ct. 64, 87 L. Ed. 533; Commissioner of Internal Revenue v. Meridian & Thirteenth Realty Co., 7 Cir., 132 F. 2d 182. The annual payments to the holders of the certificates were to be made only out of net earnings. That provision has pertinence because it is a common attribute of a debt that the holder thereof is entitled to interest thereon even though there are no net earnings. But in ordinary circumstances the holder of preferred stock has no such absolute right to the payment of dividends. Commissioner of Internal Revenue v. Meridian & Thirteenth Realty Co., supra; First Mortgage Corporation of Philadelphia v. Commissioner, supra. The certificates provided in effect that in the event of dissolution or liquidation the rights of the holders thereof should be subordinate to the rights of general corporate creditors. That provision has significance because it is normally an attribute of a creditor relationship that in the event of dissolution or liquidation creditors share in the assets before stockholders, while the only right given the holders of preferred stock is that they be paid before the holders of any other class of stock are paid. First Mortgage Corporation of Philadelphia v. Commissioner, supra; John Wanamaker Philadelphia v. Commissioner, supra.

"In respect to the intention of the parties, the taxpayer relies heavily upon certain affidavits filed in the case and a stipulation that if the affiants were present they would testify to the facts stated in the affidavits. It was stated in the affidavits that at the meeting of the stockholders the certificates were considered wholly in the nature of a loan designed to obtain necessary working capital over a twenty-year period, reserving in the corporation the right to repay the loan at any time. Standing

alone, the testimony is persuasive that the sums paid to the holders of the certificates represented payment of interest on indebtedness; and the intent of the parties in the establishment of the relationship is a factor of importance. Commissioner of Internal Revenue v. Meridian & Thirteenth Realty Co., supra; First Mortgage Corporation of Philadelphia v. Commissioner, supra. But the evidence is overborne by the action of the corporation in denominating the certificates as preferred stock, the action of the corporation in providing that the annual payments should be made only out of net earnings, the action of the corporation in providing that on dissolution or liquidation of the corporation the rights of the holders of the certificates should be subordinate to the rights of ordinary corporate creditors, the action of the corporation in setting up the transaction on the books as preferred stock, the action of the corporation in filing with the Secretary of State the certificate in which it was certified that the capital stock of the corporation consisted of common and preferred stock, and the action of the corporation in filing with the State of Oklahoma the annual franchise returns in which it was reported that the outstanding capital stock of the corporation consisted of shares of common and first preferred stock.

"Manifestly, the several pertinent elements present in the case give rise to conflicting inferences. But when they are added and weighed, we share with the trial court the view that the payments made to the holders of the certificates represented payment of dividends upon shares of preferred stock and therefore were not deductible in computing net income."

RECENT INTERNAL REVENUE SERVICE RULINGS OF INTEREST TO COOPERATIVES

1. The Revenue Service Discusses the Exemption Status of a Farmers' Cooperative Which Markets, on behalf of members, some products furnished by Nonmember Producers. (Rev. Rul. 55-496; I.R.B. 1955-32,8)

> "A cooperative marketing association which otherwise qualifies for exemption under section 521 of the Internal Revenue Code of 1954 will not be denied such exemption if it markets for members products furnished by nonmember producers, where the member is legally bound to turn back to such producers the proceeds of the sale of their products, less necessary marketing expenses, and to furnish the association with evidence that such obligation has been met, provided however, the value of the products marketed for such nonmembers does not exceed the value of the products marketed for the members.

"Advice has been requested whether a cooperative marketing association which markets products of nonmembers under the circumstances set forth below may qualify for exemption under section 521 of the Internal Revenue Code of 1954.

"An association was organized to engage in cooperative marketing of citrus fruit for its members. Its entire voting stock is held by cooperative associations, individuals, partnerships and corporations all of which qualify as producers. It markets citrus fruit for members only and operates on a strictly cooperative basis, turning back to the patrons the proceeds of sales, less necessary marketing expenses. Several of the members, however, market fruit of nonmember producers as well as their own through the association. Such fruit is handled by the agent member for the actual producers under a written agency agreement which provides that all proceeds of the fruit marketed, less only actual expenses incurred in connection therewith, shall be returned, credited and paid to the actual producers of such fruit. Products amounting in value to approximately 20 percent of the value of all products marketed by the association during the taxable year were produced by nonmembers.

"Prior to the acceptance of an agent member and prior to the marketing of any fruit by such agent member, the association

requires such member to execute and deliver to it an agreement providing, among other things, that all fruit delivered to the association on account of other producers will be the actual property of such producers and that the agent member will return to such producers the proceeds of sales of their fruit, less necessary expenses. The agreement further provides that the agent member shall furnish the association with a written authorization from each such producer showing his right to represent such producer.

"Section 39.101(12)-1 of Regulations 118, made applicable herein by Treasury Decision 6091, C. B. 1954-2, 47, provides that a cooperative association engaged in the marketing of farm products for farmers, fruit growers, livestock growers, dairymen, etc., and turning back to the producers the proceeds of the sales of their products, less the necessary operating expenses, on the basis of the products furnished by them, are exempt from income tax.

"I. T. 3853, C. B. 1947-1, 42, holds that in marketing and otherwise handling the products of nonmembers as those of its members, an association does not meet the statutory requirement that the proceeds of the sale of products, less necessary operating expenses, be returned to producers on the basis of the quantity or value of products furnished by them, since a substantial amount of the products being marketed by the members in that instance were products they had <u>purchased</u> from the nonmembers rather than products they had produced themselves.

"In this case, however, the nonmember producers retain ownership of the products marketed for them through the association. The agent member operates under an agency agreement with the nonmember producers which requires the agent member to turn back to such producers the proceeds received from the sale of their products, less the necessary marketing expenses. Moreover, the agent member is under a legal obligation to furnish the association with evidence that his agreements with nonmember producers are being carried out. Accordingly, it is held that a cooperative marketing association which otherwise qualifies for exemption under section 521 of the Internal Revenue Code of 1954 will not be denied such exemption if it markets for members products furnished by nonmember producers, where the member is legally bound to turn back to such producers the proceeds of the sale of their products, less necessary marketing expenses, and to furnish the association with evidence that such obligation has been met, provided, however, the value of the products marketed for such nonmembers does not exceed the value of the products marketed for the members."

2. The Revenue Service Rules on the Eligibility for Exemption of a Farmers' Cooperative Which Purchases Life Insurance on Its Members. (Rev. Rul. 55-558; I.R.B. 1955-36, 10)

> "A farmers' cooperative marketing association which purchases life insurance policies on the lives of its members does not meet the requirements for exemption under section 521 of the Internal Revenue Code of 1954, corresponding to section 101(12) of the Internal Revenue Code of 1939, since it would not be turning back to its members and other producers the proceeds of the sales of their products less the necessary marketing expenses.

"Advice has been requested by a cooperative association whether the purchase of life insurance policies on the lives of its five members will affect its exempt status established under the provisions of section 101(12)(A) of the Internal Revenue Code of 1939.

"The instant association is engaged in grading, packing, precooling, and marketing of vegetables for its members and other producers. Its membership is composed of five producers who contribute over 95 percent of the volume of business done by the association, the remainder being supplied by nonmember producers. In view of the large volume of products marketed for members and the effect the loss of a member's volume might have on its operation, the association has purchased a life insurance policy on the life of each of its five members, named itself beneficiary, and has undertaken to pay the annual premiums on the policies.

"A farmers' cooperative marketing association in order to meet the requirements for exemption under section 521 of the Internal Revenue Code of 1954, corresponding to section 101(12) of the 1939 Code, must, among other things, turn back to its members or other producers the proceeds of sales less the necessary marketing expenses, on the basis of either the quantity or the value of the products furnished by them.

"An association which uses any of its income in the payment of annual premiums on the life insurance policies purchased on the

lives of its members is not turning back to its members and other producers the proceeds of the sales of their products less the necessary marketing expenses. Such an expense may not be properly considered as a 'marketing' expense. Accordingly, the association does not meet the requirements for exemption from Federal income tax under section 521 of the 1954 Code, which provision of law corresponds to section 101(12) of the 1939 Code."

3. Method of Determining Unadjusted Basis of Real Property Acquired When Exempt and Disposed of When Taxable. (Rev. Rul. 55-434; I.R.B. 1955-27, 20)

> "Where a mutual savings bank, which was exempt from Federal income tax for years beginning prior to January 1, 1952 and obtained no tax benefit from bad debt losses in those years acquired at foreclosure sale in 1949 property on which it held a nonliquidating mortgage, it may not claim as the unadjusted basis of the property the amount of the mortgage indebtedness remaining unsatisfied at the time of foreclosure. The unadjusted basis of the property foreclosed for the purpose of determining gain or loss on its subsequent sale in 1953 is the fair market value of the property at the date of acquisition by the bank, as provided in section 39.23(k)-3 of Regulations 118.

"Advice has been requested as to whether the unadjusted basis of real property acquired at a foreclosure sale by a mutual savings bank in 1949, when the income of the bank was not subject to Federal income tax and no tax benefit was obtained from the loss on the foreclosure sale, is the fair market value of the property upon acquisition in 1949 or the amount of the mortgage debt immediately prior to the foreclosure sale, for the purpose of determining gain or loss when the bank subsequently sold the property in 1953, in which year its income was subject to Federal income tax.

"In 1930, the X savings bank loaned the owners of a parcel of improved real property the sum of 115x dollars, accepting as security a nonliquidating mortgage upon the premises. The grantors being in default in 1948, foreclosure proceedings were instituted by the bank in 1949 and the property was bid in at a nominal amount. At that time the entire principal amount

of the loan remained outstanding. One month after the foreclosure sale, taxpayer obtained from a firm of real estate specialists an appraisal of the property which amounted to 91x dollars. The property was sold by the bank for 90x dollars in January, 1953, a year in which the bank was subject to Federal income tax.

"Section 313 of the Revenue Act of 1951 repealed section 101(2) of the Internal Revenue Code of 1939 with respect to the exemption from Federal income tax of the income of mutual savings banks, domestic building and loan associations, and cooperative banks for taxable years beginning after December 31, 1951, and permitted such organizations to deduct for taxable years beginning after that date reasonable amounts credited to a reserve for bad debts. Since income tax deductions for bad debts were not available to such institutions for the years beginning prior to January 1, 1952, the X savings bank did not claim or obtain the benefit of any bad debt or other deduction for a loss resulting from the foreclosure in 1949.

"Section 39.23(k)-3 of Regulations 118 provides that the unadjusted basis of property acquired upon foreclosure is the fair market value of such property at the date of the acquisition thereof; that the fair market value of the property shall be presumed to be the amount for which it is bid in by the taxpayer in the absence of clear and convincing proof to the contrary. There is no provision in Federal income tax law making section 39.23(k)-3, supra, inapplicable to years during which mutual savings banks were not subject to tax. Consequently, even though the taxpayer received no tax benefit from the loss sustained, the basis of the property foreclosed must be determined in accordance with the provisions of section 39.23(k)-3. In the instant case, the value of the property was appraised 1 month after the foreclosure at 91x dollars rather than the nominal amount at which the property was bid in. A bid price less than the full amount of the claim is not conclusive evidence of the value of property acquired under foreclosure as a basis for the property upon future disposition. See Highland Creek Coal Co., Inc., v. Commissioner, Board of Tax Appeals Memorandum Opinion, entered November 30, 1940; Stormfeltz-Lovely Company Trust et al. v. Commissioner, Tax Court Memorandum Opinion, entered May 27, 1943. Therefore, the unadjusted basis of the property foreclosed, in this instance, is 91x dollars, the amount determined to have been the fair market value 1 month after foreclosure, and not the amount of the debt immediately prior to the foreclosure in 1949.

"Accordingly, it is held that where a mutual savings bank, which was exempt from Federal income tax for years beginning prior to January 1, 1952, and obtained no tax benefit during those years from bad debt losses, acquired at foreclosure sale in 1949 property on which it held a nonliquidating mortgage, it may not claim as the unadjusted basis of the property the amount of the mortgage indebtedness remaining unsatisfied at the time of foreclosure. The unadjusted basis of the property foreclosed, for the purpose of determining gain or loss on its subsequent sale in 1953, is the fair market value of the property at the date of acquisition by the bank, as provided in section 39.23(k)-2 of Regulations 118."

4. Transportation Tax - Application to Delivery Charges Under Certain Circumstances. (Rev. Rul. 55-421, I.R.B. 1955-26, 55)

> "Applicability of the transportation of property tax, imposed by section 3475 of the Internal Revenue Code of 1939, to the delivery by a truck owner of commodities purchased by him from a company where the persons to whom delivery is made have previously ordered such commodities from the company.

"Advice has been requested whether certain amounts received by a truck owner for the 'back-haul' of commodities under the following circumstances are subject to the tax on the transportation of property imposed by section 3475 of the Internal Revenue Code of 1939.

"In the instant case certain truck owners, such as farmers, grain and feed dealers, and stock and produce dealers, haul their products or wares from their homes or places of business to market in their trucks. In order to avoid returning with empty trucks they enter into arrangements with the salesmen of M Company whose plant is located near the truck owners' market, for the delivery of commodities, orders for which have been obtained by the salesmen from customers located near the truck owners' homes or places of business. Under the arrangements the truck owners purchase the commodities at M company's plant at the f. o. b. plant list price, transport them to the customers' premises, and sell them to the salesmen's customers at the delivered price previously agreed upon between the salesmen and the customers. This delivered price represents the f. o. b. plant list price of the commodity plus the amount for which the salesman believed that he could obtain transportation of the order by one of these truck owners. The truck owner

assumes no significant risk due to possible changes in the price of the commodity purchased. Furthermore, the truck owner does not perform any service from which he could gain a profit except the service of transportation.

"The tax imposed by section 3475 of the Code applies to amounts paid for the transportation of property to a person engaged in the business of transporting for hire. Section 143.1 of Regulations 113 states that such a person includes a common carrier, contract carrier, or other person transporting property for hire wholly or in part by rail, motor vehicle, water or air. The tax is payable by the person making the taxable transportation payment and is collectible by the person receiving such payment. In general, where the delivery activities of a wholesale or retail merchant are carried on with his own trucks and are merely incidental to his business of selling merchandise, the merchant is not regarded as a person engaged in the business of transporting property for hire even though a separate charge for the delivery is made to the customer. Mim. 5447, C. B. 1942-2, 280. However, where the truck owner does not have the usual indices of a merchant except the ownership of the commodities carried, and where his sole remuneration is based on a charge for transportation, the truck owner is considered to be engaged in the business of transporting property for hire. Compare with Rev. Rul. 54-463, I.R.B. 1954-42, 20.

"It is held that under the circumstances described the amount paid to the truck owner by the customer of M company in excess of the purchase price of the commodity paid by the truck owner constitutes an amount paid by the customer for transportation to a person engaged in the business of transporting property for hire within the meaning of section 3475 of the Code and is subject to the tax imposed by that section. The truck owner should collect the tax at the time the transportation charges are paid to him."